



Enhancing and Enforcing Disclosure Requirements

The Egypt Capital Markets Development Project



CHEMONICS INTERNATIONAL INC.



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International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers, dated September 1998, of the International Organization of Securities Commissions, as translated by the CMA.

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Report on Implementation of International Disclosure Standards, dated May 2000, of the International Organization of Securities Commissions.

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EXECUTIVE SUMMARY

Disclosure is the most important prudential element in a modern capital market. The most important role of a regulator with respect to issuers is ensuring that they make full and fair disclosure of all material information about their business and financial condition. The Capital Market Authority of Egypt has made great strides in improving the quality of issuer disclosure over the past several years. Nonetheless, disclosure in Egypt can be improved to meet international best practices.

Disclosure consists of two elements: financial and non-financial. The accounting and auditing standards a country uses to govern financial disclosure. International accounting standards (“IAS”) provide a guide against which local accounting standards may be measured. Egypt has adopted some, but not all, of the IASs. We recommend that the CMA amend the annexes to the Executive Regulations (ERs) under the Capital Market Law No. 95 of 1992 (“CML”) to be consistent with IAS.

International best practice for non-financial disclosure is found in the “International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers” published by the International Organization of Securities Commissions (the “IOSCO Standards”). While the IOSCO Standards have not been adopted in Egypt, some aspects of them, such as a discussion of risk factors, are recognized. We recommend that the CMA requires prospectuses and periodic reports to follow the IOSCO Standards. Disclosure by issuers takes place in two contexts. The most obvious is disclosure in prospectuses or other documents used to sell the issuer’s securities. Egypt uses prospectuses for public offerings and memorandums for private placements. Both are filed with and reviewed by the CMA.

Of equal importance to the initial disclosure made by an issuer is disclosure in periodic reports. It is only by the periodic reports that security holders and the market are kept informed of the condition, financial and otherwise, of the issuer. Egyptian public periodic reports are entirely financial in nature. Further, issuers do not mail full financial statements to security holders. Instead, only summaries are published in newspapers. We recommend that the content of periodic reports be changed so that audited financial statements are required only in annual reports. Quarterly or semi-annual reports need to contain only unaudited financial statements. Annual reports should contain the same information about the issuer as a prospectus. Non-financial information in other periodic reports should be limited to reports of material changes. Issuers should be required to mail all periodic reports to security holders as well as filing them with the CMA and the stock exchange. IAS should govern the contents of financial disclosure in periodic reports. The contents of non-financial disclosure in periodic reports should be governed by the IOSCO Standards.

Egyptian law and practice do not now require the solicitation of proxies for matters upon which shareholders may vote. We recommend that solicitation of proxies be required and that the solicitation contains information about directors, officers, and auditors and their compensation. Again, the IOSCO Standards would govern disclosure in proxy solicitations.

ENHANCING AND ENFORCING DISCLOSURE REQUIREMENTS

2. Introduction

2.1 Definition of “disclosure”

As used in this report, “disclosure” has two meanings. The first meaning of disclosure describes the information revealed, or disclosed, by companies (or issuers) about themselves.

The second meaning of disclosure describes the processes and procedures used by companies to make the information about themselves available to security holders, other investors, regulators, market participants and the public. This use of the word disclosure does not normally include information about the market’s activities in the issuer’s securities. However, issuers are required to disclose market information when that information relates to the terms of an offering of the issuer’s securities, a tender offer for the securities, or other unusual market information which the issuer is required by law or regulation to obtain and reveal.

2.2 Role and types of disclosure

Disclosure by companies forms the core of the securities regulatory systems of the United States, Canada, and Western Europe. Regulatory agencies, both governmental and self-regulatory, devote their efforts to refining and enforcing disclosure standards. Regulatory agencies rely upon disclosure to guide the public in making investments and do not recommend or forbid investments in particular issuers, relying instead upon investors to make up their own minds after receiving all material information.

Information required to be disclosed by issuers has traditionally been divided into two main types:

(1) The first type of disclosure is the information required for offerings of securities. Disclosure for offerings is itself divided into two categories of information: (a) The first category of information describes the business, securities, directors, management and other information about the issuer. (b) The second category of information describes the terms and conditions of the offering.

(2) The second type of disclosure is periodic reporting by an issuer. It is made in an annual report, quarterly or semi-annual reports, and interim reports. In the United States, the annual report of an issuer is a complete description of the issuer and includes audited financial statements for the past three to five years. The annual report, therefore, looks much like a prospectus, except that it has no information relating to a specific offering. In the United States, quarterly reports consist of abbreviated financial statements that are reviewed, but not audited, by the company’s auditors. Non-financial disclosure in quarterly reports is extremely limited. Interim reports are filed only when specified events occur. The nature of the event being disclosed determines whether any financial statements are required in a special report.

Disclosure in Egypt is governed by the CML and the ERs under it. The contents of a prospectus are prescribed by Annex 1 of the Executive Regulations for non-financial information and Annexes 2 and 3 for financial information.

2.3 Materials relating to disclosure

CMD project has worked over the last two years with the CMA in reviewing existing disclosure requirements and practices in Egypt and assessed them against the relevant international standards and best practices adopted in developed countries.

In this regard, CMD has given the CMA several documents related to disclosure by issuers. Each of them provides detailed discussion and analysis on a specific disclosure issue. This report capitalizes on and consolidates most of the recommendations made in previous reports to provide a comprehensive document on enhancing disclosure requirements and CMA enforcement of them.

- (1) A report entitled, “Financial Statement Presentation and Disclosure Requirements, A Comparison between Egyptian and International Accounting Standards,” dated March 1999, by the CMD Project.
- (2) Memorandum, dated July 20, 1999, by Jim Reum of Winston & Strawn, entitled, “Egyptian Capital Markets, Proposal for Revising Public Company Non-Financial Statement Disclosure Requirements.”
- (3) Memorandum, dated Draft 5/3/99, by Jim Reum of Winston & Strawn, entitled, “Egyptian Capital Markets, Issuer Disclosure-Periodic Reporting.”
- (4) Memorandum, dated September 9, 1999, by Jim Reum of Winston & Strawn, entitled “Egyptian Capital Markets, Assessment of Scope and Nature of Potential Regulation of Proxy Solicitation and Disclosure.”
- (5) Memorandum, dated September 24, 1999, by Jim Reum of Winston & Strawn, entitled, “CMA Report Forms.”
- (6) A Report on the Adequacy of Egyptian Financial Disclosure Requirements and Recommended Enhancements, dated November 15, 2000, by Dr. A Sondhi.
- (7) Memorandum, dated November 10, 2000, by Brian Riddell, entitled, “Listing Rules of The Cairo and Alexandria Stock Exchange.” Only Rules 225 through 229 deal directly with disclosure.
- (8) Proposed rule dated 10 May 2000 by CMD, entitled, “Rule on Advertising (Pursuant to Article 223 of the Executive Regulations).
- (9) Proposed rule dated 27 July 2000 by CMD, entitled, “Rule on Selective Disclosure by Issuers.”

In addition, we attach to this report the following documents:

Annex A to this Report is the translation by the staff of the CMA of the IOSCO “International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers.”

Annex B to this Report is the “IOSCO Report on Implementation of International Disclosure Standards.” dated May 2000, which was not previously delivered to the CMA by the CMD. Note that several developed nations, including Australia, eight nations in the European Union

and the United States of America, and an emerging market, Mexico, require or permit use of IOSCO Standards by domestic or foreign issuers. The United States Securities and Exchange Commission adopted the IOSCO disclosure standards for use by foreign companies starting in 2000. The IOSCO Standards apply to offerings, listing in the United States and the annual report required of all companies registered with the SEC.

2.4 Structure of this report

The remainder of this report is divided into four main parts — financial disclosure (Part 3), non-financial disclosure (Part 4), dissemination of information (Part 5) and enforcement (Part 6). Each topic of discussion is arranged as follows: existing requirements, CMD comments and CMD recommendations.

ENHANCING AND ENFORCING DISCLOSURE REQUIREMENTS

3. Financial Statement Disclosure Requirements

3.1 Issuing securities

According to article (2) of the CML, any company wishing to issue securities must file a registration statement with the CMA. The CMA has the right to object thereto within three weeks from the date of filing. Otherwise the company has the right to go ahead with the issuing procedures. Article (7) of the executive regulations to the CML specifies the information and documents required for the registration statement.

3.1.1 Initial public offering of shares at incorporation

I. Using proceeds in acquiring an existing business

Existing Requirements

Article (42) of the ERs requires a prospectus for the public offering of shares at incorporation. Among other data, a list and content of contracts concluded by the founders on behalf of the corporation should be included in the prospectus. If the subject of any of these contracts was to acquire an existing business, a summary of the auditor's report of this business should be included in the prospectus.

CMD Comments

The required summary of the auditor's report has a minimal value to potential investors as long as the audited financial statements of the acquired business are not included in the prospectus. IOSCO disclosure standards require that if the proceeds may or will be used to finance acquisitions of another business, a prospectus should provide a brief description of such business and information on the status of the acquisition. Schedule (A) to the U.S. Securities Act of 1933 (as amended) requires filing the audited income statement of the acquired business for three preceding financial years, a balance sheet of a date not more than 90 days prior to the date of filing the registration statement and the latest audited balance sheet of a date not more than one year prior to the filing date.

CMD Recommendations

We recommend that, in case all or part of the proceeds are used to acquire an existing business, the prospectus must include the full audited financial statements of this business for the three preceding financial years along with adequate description of that business and its operations.

II. Ratification of the prospectus by the auditors

Existing Requirements

Articles (27) and (46) of the ERs require that a prospectus for a public offering of shares, whether at incorporation or in a capital increase, be ratified by the company's auditor for validity of data and compliance with the CML and its ERs. The auditor's report should be filed, along with the prospectus, with the CMA.

CMD Comments

A prospectus includes financial and non financial information on the issuer's operations, organization, management, products and services, and the terms, conditions and other legal aspects of the offering. It is, hence, inappropriate and impracticable to require the auditor to ratify the validity of data included in the prospectus and the compliance with the CML and its ERs.

Section 7(a) of the U.S. Securities Act of 1933 requires that "if any accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, is named as having prepared or certified any part of the registration statement, or is named as having prepared or certified a report or valuation for use in connection with the registration statement, the written consent of such person shall be filed with the registration statement."

Schedule (A) to the U.S. Securities Act of 1933, requires that an opinion of counsel with respect to the legality of the issue be filed with all registration statements.

CMD Recommendations

We recommend amending articles (27) and (46) of the ERs to limit the requirement for the auditor ratification of the prospectus to only financial statements and any information extracted from them. Also, we recommend adding a new requirement for filing written consents of all professionals whose names appear on any part of the prospectus/registration statement or any report used in connection with such documents. We also recommend adding a new requirement to file the written opinion(s) of the counsel as to the legality of the issue.

3.1.2 Public offering of shares in a capital increaseExisting Requirements

Article (5) of the CML requires that a prospectus for a public offering of shares in a capital increase to include a summary of the audited financial statements, for three preceding financial years or the period from foundation, if shorter, prepared in accordance with the disclosure rules set forth in the ERs and the forms to be developed by the CMA.

Annex (1) to the ERs outlines a form for a prospectus for offering shares to the public. Item (7) of this form outlines the summary of the audited financial statements as a balance sheet presented in T-form with comparative figures for the pervious two years along with the auditor's report thereon. No other financial statements are included in this form.

CMD Comments

A summary of audited financial statements is inadequate for the purpose of the public offering of securities in an existing company for the following reasons:

The form in the executive regulations requires only a balance sheet presented in the abandoned T-form along with one auditor's report. This will omit significant information disclosed in the other financial statements (i.e. statements of income, cash flows, and changes in shareholders' equity) as well as information disclosed in the notes to the financial statements which represent, according to the accounting and auditing standards, an integral part of the audited financial statements. These notes provide very useful information for a

better understanding of the financial statements. They disclose the accounting policies followed by the company's management in preparation of the financial statements as well as proper analysis of the captions presented on those statements.

Although, the current practices reveal that issuers, usually, disclose financial information more than that required by Annex 1, any summary of financial statements will omit certain information that could be material to potential investors and their investment decisions. The selected information published will always be at the discretion of the issuer and could be a matter of dispute with the CMA.

1. According to the Egyptian and International Standards on Auditing (ESAs and ISAs), the auditors' report and opinion expressed therein cover only the financial statements for one year. This means that no one single audit report can cover the audited financial statements for the three preceding financial years included in the prospectus.
2. According to the accounting standards, financial statements of any financial year of a company, other than the first financial year, should present comparative figures for the previous financial year. This means that the three-column form of the ERs presents only figures for two audited financial statements.
3. There is no limitation on the age of the audited financial statements presented, as long as they are the latest audited financial statements, or a requirement for updated interim financial statements.

Article (58) of the ERs to the CML requires financial statements of publicly held companies to be prepared according to the Egyptian Accounting Standards (EASs) and to be audited in accordance with the ISAs. This requirement, however, is inadequate for the purpose of disclosure in a public offering of securities because:

- a) It is applicable only to the periodic reporting by companies
- b) It is applicable only to publicly held companies and securities companies

CMD Recommendations

1. Full audited financial statements for the three preceding financial years or for the period from the foundation, if shorter, should be included, year by year, in a prospectus for public offering of shares in a capital increase rather than a summary of such statements. This recommendation requires amendment of article (5) of the CML.
2. Replacing the form of the prospectus in Annex 1 to the ERs by a revised Arabic version of IOSCO disclosure standards.
3. Add a new requirement to Article (43) of the ERs that the financial statements included in a prospectus should be prepared in accordance with the EASs and audited in accordance with the ESAs:
 - a) If any of these financial statements are prepared in accordance with accounting practices other than the EASs, they should be reformatted into EASs, with a reconciliation between net profits reported under EASs and those reported in the original financials, if different. The reformatted financial statements should be

compiled by the company's auditor with an "Accountant Report" on this compilation service.

- b) If the company's current auditor audited any of the presented financial statements in accordance with auditing practices other than ESAs or ISAs, he should reaudit them in accordance with those standards and issue a new audit report for each of the periods covered. If the current auditor of the company was not the auditor for any of the periods covered, he should carry out a full scope examination of the financials in accordance with the ESAs and/or ISAs and issue a report same as the regular audit report. But because he was not the statutory auditor during these periods, his report will be titled "Accountant's Report" rather than "Auditor's Report" and will be addressed to the board of directors rather than the shareholders.
 - c) No specific disclosure rules have been issued in the executive regulations for the financial statements included in a prospectus. The importance of such rules lays in those situations where the previous financial statements of the issuer are prepared in accordance with accounting practices other than the EASs. Examples for such situations include public enterprise companies which prepare their financials in accordance with the Unified Accounting System (UAS) and privately held companies which apply accounting practices that were commonly used before issuing the EASs. Also auditors of public enterprise companies from the Central Auditing Organization (CAO) usually do not follow the ISAs and their reports are not in conformity with those standards.
4. A new requirement to be added to article (43) of ERs that the last year of audited financial statements may not be older than 15 months at the time of offering or listing, provided, however, that in case of the company's initial public offering, unless the CMA permits otherwise, the audited financial statements also shall be of a date not older than 12 months at the time of the offer or filing a registration statement. In such cases, the audited financial statements may cover a period of less than a full year.
 5. If the prospectus is dated more than nine months after the end of the last audited financial year, it should contain interim financial statements, which may be unaudited (in which case that fact should be stated), covering at least the first six months of the financial year. The interim financial statements should include comparative statements for the same period in the prior financial year, except that the requirement for comparative balance sheet information may be satisfied by presenting the last audited balance sheet. The interim financial statements should include note disclosure that will provide an explanation of events and changes that are significant to an understanding of the changes in financial position and performance of the enterprise since the last annual reporting date. If, at the date of the prospectus, the company has published interim financial statements that cover a more current period than those required by the regulations, the most current interim financial statements must be included. Companies are encouraged, but not required, to have any interim financial statements in the prospectus reviewed by an independent auditor. If such a review has been performed and is referred to in the prospectus, a review report must be included as well.

3.1.2 Public offering of shares by a shareholder

Existing Requirements

There is no requirement for publishing a prospectus in case of offering shares to the public by an existing shareholder in a closely held company. The existing practice in the market is to publish a “Sale Notice” describing the sale procedures and timing and number of shares offered.

CMD Comments

Selling securities of an issuer for the first time to the public by a shareholder has the same implications as an IPO by an issuer because of the inadequate disclosure, if any, to the market prior to the offering.

CMD Recommendations

Selling securities of an issuer for the first time to the public by an existing shareholder should be subject to the same requirements of a public offering by an issuer including requirement for a prospectus. This recommendation is applicable to the public enterprise holding companies when they offer to sell to the public their stake in affiliated companies for the first time. It is, also, applicable to any closely held company when it goes public by offering the stake of one or more of its existing shareholders.

3.1.4 Public offering of securities by an underwriter

Existing Requirements

Article (121) of the ERs to the CML permits underwriting companies to subscribe to securities offered in public offerings or private placements and to re-offer securities acquired to the public according to the same conditions and terms set forth in the approved prospectus within one year from the date of the CMA approval of the prospectus. Article (52) of the ERs permits only a four-month period, from the date of the CMA approval, for subscription in shares offered in a public offering with exemption for the securities offered by an underwriter.

CMD Comments

The one-year period allowed for underwriters to re-offer the securities they acquired to the public using the same prospectus is relatively long. Financial position, operating results, and cash flows of the issuers could be materially changed a short time after receiving the proceeds of the offering. Hence, financial statements included in a prospectus would not be useful for re-offering the securities by an underwriter after one year.

CMD Recommendations

We recommend that, in case of a public offering of securities by underwriters on a date that is 60 days later than the date of the initial offering or 120 days of the date of the CMA approval of the initial offering, the issuer and the underwriter(s) should prepare and file with the CMA a supplement to the prospectus. The supplement would report the completion of the first phase of the public offering and show interim financial statements reflecting the use of proceeds of the offering. (A supplement is a small addition to the original prospectus used to report the

completion of events anticipated in the prospectus.) If new audited financial statements had become available prior to the later use of the prospectus by the underwriters, a new prospectus containing full audited financial statements would be required.

3.1.5 Initial public offering of debt securities

Existing Requirements

Article (44) of the Executive Regulations requires filing and publishing a prospectus for the public offering of debt securities and outlines information that should be included in this prospectus. Among other information required, is a summary of estimated budgets of the company for the term of the security issued with determination of important financial ratios for financial structure and profitability provided that the company's auditor ratifies the validity of the financial data stated therein.

CMD Comments

The substance of the existing requirement is very good for adequate disclosure to bondholders to assess the ability of the issuer to pay back debt and interest in a timely manner. It is, however, not accurately worded for the following reasons:

1. "Estimated budgets" is not an appropriate term because it is very broad and is commonly used to refer to all projections made by the management for its operations during coming periods including production, marketing, selling, purchasing and finance budgets, as well as projected financial statements. For the purpose of adequacy of disclosure and for the confidentiality of the company's information, only prospective financial statements whether projected or forecasted should be included in a prospectus.

The requirement for only a "summary" of the prospective financial statements is inadequate because omitted information may be of significant impact on prospective investors specially the underlying assumptions and accounting policies used in preparation of the prospective financial statements.

The current practices showed that auditors do not issue proper reports for examination of the prospective financial statements included in a prospectus. The reason may be due to the absences of relevant audit standards to guide auditors in carrying out such assignments and reporting thereon.

CMD Recommendations

We recommend:

2. Amending Article (44) of the ERs to require incorporation of full prospective financial statements, including notes to the financial statements on underlying assumptions and accounting policies used together with the Auditors' Examination Report thereon.
3. Make reference to the applicable audit standards to be followed by auditors in examining and reporting on prospective financial statements included in a prospectus (i.e., ESA no. 230 and/or ISA no. 810).

3.1.6 Consolidated Financial Statements

Existing Requirements

EAS (17)- *Consolidated Financial Statements and Accounting for Investments in Subsidiaries* requires parent companies with certain conditions to prepare and present two sets of financial statements; consolidated financial statements for *the Group* (i.e. the parent company and its subsidiaries) and its own financial statements. The CML and its ERs have no provisions regarding which set of financial statements should be included in a prospectus in case of offering securities to the public by a parent company.

CMD Comments

The consolidated financial statements provide investors and creditors with more useful and valuable information than those provided by the parent company's financial statements. Capitalization and debt/equity ratios, for instance, are more informative if calculated based on a consolidated balance sheet rather than based on the parent company's balance sheet. IOSCO financial disclosure standards require that prospectus to include consolidated financial statements rather than parent's financial statements.

On the other hand, *the group*, however, has neither legal entity nor power in the Egyptian laws to issue securities and, hence, only parent companies have such entity and power to issue securities.

CMD Recommendations

We recommend that, in case of offering securities to the public by a parent company, the financial statements for the parent company and the consolidated financial statements, whether historical or prospective according to the circumstances, should be included in the prospectus.

3.1.7 Private placements

Existing Requirements

There are no legal standards in the CML or ERs to determine the difference between a private placement and a public offering. However, the disclosure document for a private placement (closed offering) must be presented to the CMA for review.

CMD Comments

Private placements in the United States are governed by Regulation D of the Securities and Exchange Commission. Regulation D defines a private placement in terms of a variety of conditions that have to be met by the issuer and its underwriter. These include:

1. "Accredited Investors." Accredited investors are individuals or institutions. Individuals must have at least \$1,000,000 in net worth, or income of at least \$200,000 per year or \$300,000 per year for a married couple. Institutions must have at least \$5,000,000 in total assets.
2. Information. If the issuer sells only to accredited investors, no specific information is required to be given to them. The presumption is that these investors are able to " fend for

themselves” and demand whatever information they want to have. That is, unless they get the information they want, they will not buy the issuer’s securities. As a practical matter, most issuers selling to individuals prepare private placement memorandums that are as detailed as prospectuses for public offerings. Issuers selling to institutions may provide a similar private placement memorandum unless they have a continuing relationship with the institution, in which case they may provide only recent financial statements. In both cases, the private placement agreement between the issuer and the purchasers is likely to have covenants with respect to the status of the issuer. The private placement memorandum is not filed with the SEC or any other federal agency.

3. Number of purchasers. There may not be more than 35 purchasers who are not accredited investors. That is, accredited investors are simply not counted. That is why there have been private placements to hundreds of institutions of hundreds of millions of dollars of securities. There are rules for counting spouses and relatives who live in the same house as one purchaser. Companies that are not accredited investors may be excluded from the count if all of their shareholders are accredited investors. There are other technical rules on counting.
4. Limitations on manner of offering. There may be no advertising or any general solicitation. The issuer and any underwriter or broker acting for the issuer are forbidden to publish any advertisements in the press, on radio, TV, Internet, etc. They may not solicit any persons or institutions except those that they already know. (The underwriters or brokers must follow the “Know your customer rule.” This prevents them from offering the private placements to anyone for whom the security is not an appropriate investment.)
5. Limitations on resale. The securities cannot be resold publicly without registration with the SEC in a separate transaction. They may not be sold privately except in a manner and to purchasers who could have purchased them originally. A “stop transfer” order is entered in to the books of the transfer agent (in Egypt, the MCSD). A purchaser who resells must satisfy the issuer and its lawyers that any person to whom he transfers the securities meets the tests for an accredited investor.
6. Report to SEC. After the private placement is over, the issuer is required to report the transaction to the SEC by filling in a form and filing it.

CMA Recommendations

The distinction between a private placement and a public offering should be clear so that issuers and their underwriters can comply with the standards applicable to them. The CMA can do this by adopting a rule similar to Regulation D of the SEC. The CMA does not need to review the disclosure documents for private placements.

3.1 Periodic reports by listed companies

3.2.1 Annual reports

1. Accounting and auditing standards

Existing Requirements

Article (6) of the CML requires publicly held companies to file, with the CMA, yearly and half-yearly reports on its activity and operating results including audited financial statements. Financial statements are to be prepared and audited according to the accounting and auditing standards to be identified by the ERs.

Article (58) of the ERs to the CML requires financial statements to be prepared according to the Egyptian Accounting Standards (EASs), audited according to the International Standards on Auditing (ISA), and presented according to the format on Annex 3 to the ERs.

In October 2000, Egyptian Standards on Auditing (ESAs) were issued by the ministerial decree No. 625. This decree requires application of ESAs to audit financial statements issued after September 30, 2000. ISAs will be applied to auditing issues not covered by the ESAs.

In case of a publicly held parent company, there are no provisions in the CML, its ERs and the Stock Exchange listing rules to identify whether consolidated financial statements should be periodically filed or not.

CMD Comments

Egyptian Accounting Standards

1. Great efforts have been made to introduce and adapt the IASs to the Egyptian business environment and to develop the EASs, which are, generally, similar to the IASs.
2. The EAS No. 20 “Finance-lease contracts” is significantly different from the corresponding IAS.
3. Only 22 EASs have been issued compared to 39 IASs issued to date (of which two standards were subsequently superseded; i.e. only 37 IASs are outstanding). The following important accounting issues are not covered by the EASs issued to date:
 - Reporting financial information by segment (IAS 14)
 - Business combination (IAS 22)
 - Financial reporting of interest in joint ventures (IAS 31)
 - Financial instruments: disclosure and presentation (IAS 32)
 - Financial instruments: recognition and measurement (IAS 39)
 - Accounting for taxes on income (IAS 12)
 - Interim financial reporting (IAS 34)

- Discontinuing operations (IAS 35)
 - Impairment of assets (IAS 36)
 - Intangible assets (IAS 38)
 - Employees and the cost of retirement benefits (IAS 19)
 - Provisions, contingent liabilities, and contingent assets (IAS 37).
4. In 1998 and 1999, many IASs have been revised or reformatted with no update to the corresponding EASs. The following are the IASs affected by the revision:
- IAS 1 “Disclosure of Accounting Policies”
 - IAS 5 “Information to be Disclosed in Financial Statements”
 - IAS 13 “Presentation of Current Assets and Current Liabilities”
 - IAS 8 “Net Profit for the Period, Fundamental Errors, and Changes in Accounting Policies”
 - IAS 9 “Research and Development Costs”
 - IAS 16 “Property, Plant, and Equipment”
5. In the absence of an official translation of the IASs, they will not be used as required by the ERs to cover issues not currently covered in EASs.
6. The presentation of financial statements according to the format in Annex 3 to the ERs to the CML is different from the presentation requirements according to “*IAS 1- Presentation of Financial Statement*” as follows:
- The presentation requirements have not been issued as part of the EASs but as an appendix to the CML’s ERs, whereas those requirements are provided for separately in IAS 1, “Presentation of Financial Statements.”
 - Under the Egyptian presentation requirements, four statements need to be prepared — balance sheet, statement of income, statement of cash flow, and statement of proposed dividends. IAS 1 also requires four statements be prepared, the last one of which is different from the Egyptian requirements — balance sheet, statement of income, statement of cash flow, and statement of changes in equity.
 - The financial statements in the ERs are relatively more detailed than they need to be. This is due to confusion between presentation and disclosure requirements. For instance, breakdowns of property, plant and equipment, and inventory are presented on the face of the balance sheet rather than being disclosed as a note to the financial statements. Also, the market value of marketable securities is presented on the face of the balance sheet rather than as a note to the financial statements.

- The balance sheet provided by the ERs emphasizes the direct presentation of the working capital, whereas the balance sheet in the IASs shows total assets and total liabilities, distinguishing between current and non-current items.
- The income statement of IAS 1 distinguishes between operational and non-operational activities within the results of the ordinary activities, whereas the income statement in the ERs does not.
- Extraordinary income and expenses should be offset and presented net of tax on the income statement according to IAS 1. Those items are presented separately on the income statement in the ERs.
- Income tax expense is presented as one caption on the Egyptian income statement, while only income tax expense on the profit from ordinary activities is presented on the income statement according to IAS 1, and taxes on extraordinary profits are netted against these profits.
- Up-to-date, public-sector companies are obligated to apply the Unified Accounting System (UAS), which identifies accounting policies, principles, and presentation and disclosure requirements for financial statements. In certain aspects, the UAS requirements are different from those of the EASs. Accordingly, public-sector companies used to issue two sets of financial statements (one set in accordance with the UAS and another set in accordance with the ERs' presentation requirements), which is very confusing when published together. It is very difficult to trace and reconcile figures presented on one set of financial statements to the other.
- The EASs were issued without a framework for developing and publishing new EASs compared to the framework of the IASs.

Egyptian Standards on Auditing

1. Only six ESAs were issued to date compared to thirty-four ISAs. Generally, ESAs are similar to the corresponding ISAs. The following is a list of audit issues not covered by ESAs:
 - ISA 200- Objective and General Principles Governing an Audit of Financial Statements
 - ISA 220- Quality Control for Audit Work
 - ISA 230- Documentation
 - ISA 240- Fraud and Error
 - ISA 250- Consideration of Laws and Regulations in an Audit of Financial Statements
 - ISA 300- Planning
 - ISA 310- Knowledge of Business
 - ISA 320- Audit Materiality

- ISA 400- Risk Assessment and Internal Control
 - ISA 401- Auditing in a Computer Information Systems Environment
 - ISA 402- Audit Considerations Relating to Entities Using Service Organizations
 - ISA 500- Audit Evidence
 - ISA 501- Audit Evidence — Additional Considerations for Specific Items
 - ISA 510- Initial Engagements — Opening Balances
 - ISA 520- Analytical Procedures
 - ISA 530- Audit Sampling and other Selective Testing Procedures
 - ISA 540- Audit of Accounting Estimates
 - ISA 550- Related Parties
 - ISA 560- Subsequent Events
 - ISA 570- Going Concern
 - ISA 580- Management Representations
 - ISA 600- Using the Work of Another Auditor
 - ISA 610- Considering the Work of Internal Auditing
 - ISA 620- Using the Work of an Expert
 - ISA 710- Comparatives
 - ISA 920- Engagements to Perform Agreed-Upon Procedures
 - ISA 930- Engagements to Compile Financial Information
2. In the absence of an official translation of the ISA, the application of those standards will not be completed as required by the ERs.
 3. Also, in the absence of a self-regulation for the public accounting profession, quality of audit work can not be assured specially, for audits carried out by small accounting firms.
 4. As mentioned above, public enterprises' auditors from the CAO do not apply the ESA.

Publicly held parent company

As mentioned above, consolidated financial statements provide investors with more useful and valuable information than those provided by the parent's financial statements. Hence, consolidated financial statements should be filed by publicly held parent companies along with their own financial statements.

CMD Recommendations

1. Amend EAS 20 for finance-lease contracts to be consistent with the corresponding IAS
2. Issue new EASs to cover issues, in IASs, not covered so far
3. Revise the EASs to be consistent with the corresponding IAS
4. Eliminate Annexes 3b, 3c and 3d to the ERs
5. Create a framework for developing and publishing the EASs comparable to the framework for IASs
6. Eliminate application of the UAS by public enterprises
7. Issue new ESAs to cover all issues not covered so far
8. Promote the public accounting profession in Egypt to become self regulated to play an effective role in monitoring and enforcing consistent accounting and auditing standards and codes of professional ethics and conduct among its members of public accountant
9. Extend application of ESA to public enterprises
10. CMA initially (and private organizations thereafter) should sponsor workshops for private accountants and lawyers to increase their familiarity with CMA's issuer disclosure requirements, including compliance with Egyptian accounting and auditing standards.
11. ERs and listing rules should make explicit requirements for periodical (annual, semi-annual, quarterly) filing of consolidated financial statements by parent companies in addition to their own financial statements.

3.2.1 Semi-annual reportsExisting Requirements

As mentioned above, Article (6) of the CML requires half-yearly reports to include audited financial statements.

CMD Comments

This requirement is impractical for the following reasons:

1. The practice shows that companies would not and/or could not comply with this requirement because it consumes time and money. Auditors usually take a two month period to perform a full scope audit of financial statements.
2. Despite the fact that there are no statistics available on the number of companies that have complied with this requirement, we do believe, they are very rare, if any.

CMD Recommendations

We recommend eliminating the requirement for half-yearly audited financial statements. The quarterly reviewed financial statements could serve the purpose of updated regular disclosure.

3.2.3 Quarterly reports*Existing Requirements*

There is no direct requirement in the CML or its ERs for quarterly reporting of financial statements. The Stock Exchange listing rules, however, require all listed companies to file, with the Stock Exchange and the CMA, quarterly reviewed financial statements. There are no requirements for making these statements public.

CMD Comments

This requirement is good. There are, however, no EASs for the preparation and presentation of interim financial statements.

CMD Recommendations

As recommended above, new EASs should be issued to cover all accounting issues not covered to date. Among other issues that should be covered is the interim financial statements. On the other hand, CMA regulations as well as CASE listing rules should specifically require quarterly reports.

3.2.4 Special reports*Existing Requirements*

Article (6) of the CML requires issuers to disclose immediately any material information that would affect their business or financial position. No particular format is designated for these extraordinary disclosures.

CMD Comments

There are no standards set for material information and no standards set for determining what financial information must be disclosed.

CMD Recommendations

The CMA should develop a form of disclosure for special reports to be filed with the CMA and CASE to report extraordinary events. If the special report requires financial information, appropriate financial statements should be included.

ENHANCING AND ENFORCING DISCLOSURE REQUIREMENTS

4. Non-financial Statement Disclosure Requirements

4.1 Issuing securities

Existing Requirements

See Section 3.1 of this report for a description of five types of public offerings of securities and the state of their regulation by the ERs. Current Egyptian requirements for non-financial disclosure in prospectuses are set forth in Article (5) of the CML, Articles (27) and (42) through (45) of the ERs and Appendix No. (1) of the ERs.

CMD Comments

These requirements differ in many ways from the IOSCO Standards. In the main, the Egyptian requirements lack the specificity and detail of the IOSCO Standards. There is no way to determine by reading the CML or the ERs the extent of the information that is actually required in a prospectus.

CMD Recommendations

We recommend that the IOSCO Standards be adopted for use in Egypt for all public offerings by domestic or foreign issuers. The full text of the IOSCO Standards and the Arabic translations of them are in Annex A. Because the IOSCO Standards are specifically designed for offerings, they apply in their entirety to every kind of public offering in Egypt. Only if there were circumstances peculiar to a particular offering or issuer would any item be unnecessary.

The IOSCO Standards are divided into nine parts and a miscellaneous part entitled “Additional Information.” Those parts relating specifically to an offering or a listing are:

- I. Identity of Directors, Senior Management and Advisors
- II. Offer Statistics and Expected Timetable
- III. Key Information
- IX. The Offer and Listing.

The parts of the IOSCO Standards that contain information that is also required for an offering or listing, but describe the issuer, not the offering, are:

- IV. Information on the Company
- V. Operating and Financial Review and Prospects
- VI. Directors, Senior Management and Employees
- VII. Major Shareholders and Related Party Transactions
- VIII. Financial Information
- X. Additional Information

The IOSCO Standards give details of the information to be disclosed by the issuer in an offering. However, no disclosure standards, however detailed, can cover every situation. Therefore, the specific disclosure requirements must be supported by rules that require the disclosure of all material information and any other information required to make the statements that are made not misleading. The rules must also forbid the omission of any material fact. A draft of such a rule is in Annex C.

4.2 Periodic reports by listed companies

4.2.1 Annual reports

Existing Requirements

The current CML and ERs do not require an annual report to contain non-financial information about the issuer. However Article 221 of the Executive Regulations under the Companies Law requires an annual report to shareholders. Annex 1 of these Executive Regulations outlines the data to be included in the board of directors' report to shareholders.

CMD Comments

The current requirement specifying only financial information in publicly available annual reports does not meet international best practices or the needs of the Egyptian market for current information about issuers. We note that the disclosure process created by the draft of the new CML is completely different from the current law and practice. The new CML introduces into Egyptian law the concept of a reporting company. A reporting company is one that (1) has a certain number of shareholders (the number being left to the ERs), (2) is listed on a stock exchange or (3) wishes to make a public offering of its securities. A reporting company will be required to file annual and other periodic reports. The annual report will contain all of the information that would be in a prospectus except that which relates directly to an offering or listing.

Under the draft of the new CML, a reporting company wishing to make an offering will use its annual and other periodic reports accompanied by a prospectus that contains a description of the offering and the securities being offered. The prospectus will be required to contain only the information specified by the IOSCO Standards for the offering itself, not the description of the issuer. (Presumably a company making an initial offering (public or private) will file its disclosure as a periodic report instead of as a prospectus.)

CMD Recommendations

We recommend that listed companies be required to file with CMA and CASE an annual report containing audited financial statements and the information required by the IOSCO Standards. The following parts of the IOSCO Standards govern information that is contained in an annual report:

- I. III. Key Information, D. Risk Factors
- II. Information on the Company
- III. Operating and Financial Review and Prospects [See Annex E to this Report.]
- IV. Directors, Senior Management and Employees
- V. Major Shareholders and Related Party Transactions
- VI. Financial Information
- VII. Additional Information

4.2.2 Semi-annual reports

Existing Requirements

There are no existing requirements that semi-annual reports contain non-financial information.

CMD Comments

Semi-annual reports in the United States do not contain non-financial information other than the material that corresponds to IOSCO Standards, “Part V. Operating and Financial Review and Prospects.”

CMD Recommendations

We recommend that semi-annual reports not differ in form from the reports prepared at the end of the first and third quarters. The only non-financial information to be contained in them should be IOSCO Standards, “Part V. Operating and Financial Review and Prospects” and a listing of special reports made since the last annual or quarterly report.

4.2.3 Quarterly reportsExisting Requirements

There are no existing requirements that quarterly reports contain non-financial information.

CMD Comments

Quarterly reports in the United States do not contain non-financial information other than the material that corresponds to IOSCO Standards, “Part V. Operating and Financial Review and Prospects.”

CMD Recommendations

We recommend that quarterly reports be in the same form for each of the first three quarters of the year. There would be no quarterly report for the fourth quarter because that period will be covered in the annual report. The only non-financial information to be contained in quarterly reports should be IOSCO Standards, “Part V. Operating and Financial Review and Prospects” and a listing of special reports made since the last annual or quarterly report.

4.2.4 Special reportsExisting Requirements

Article (6) of the CML requires issuers to disclose immediately any material information that would affect its business or financial position. A summary of this information is to be published in two newspapers. The CMA has no requirement that the information be filed with it in any particular form.

CMD Comments

Article (6) recognizes the importance of prompt disclosure of material information.

CMD Recommendations

The CMA should require issuers to file promptly with it and with CASE a report of any material information affecting the business or financial position of the issuer. It may be helpful to specify certain things which will always be considered material (bankruptcy, failure to pay principal or interest on publicly held debt, change in managing director, signing

new material contracts, obtaining or losing a material license, etc), without limiting disclosure to those items if other information meets the test of materiality.

4.3 Solicitation of proxies for shareholders' votes

Shareholders' votes are cast at annual general meetings and at extraordinary meetings.

Existing Requirements

There are no existing requirements for solicitation of proxies for any matters subject to shareholders' votes.

CMD Comments

International best practice recognizes that the right of shareholders to vote is one of the fundamental rights of ownership of shares. As a result, regulation of proxy solicitations is frequently dealt with in capital market laws or regulations. Document (4) listed above in Section 2.3 makes recommendations for a proxy solicitation system. Unfortunately there is no basis for the proposal in the existing Capital Market Law, but the proposal would be authorized in part by Articles 80 and 81 of the draft Capital Market Law. This is an area in which the new law gives virtually unfettered power to adopt Executive Regulations relating to the election of directors. The new CML does not address solicitation of proxies for other shareholders' actions (such as a merger, increase in capital, etc.).

CMD Recommendations

We recommend that issuers be required to solicit the votes of shareholders on all matters upon which shareholders vote. We also recommend that the CMA or CASE establish disclosure standards for the solicitation of votes. The disclosure standards would apply both to boards of directors and to any other persons soliciting the votes of shareholders.

Solicitations of proxies for shareholders' votes should contain the following parts of the IOSCO Standards if the meeting is an annual general meeting at which directors and the auditor are elected:

VI. Directors, Senior Management and Employees

VII. Major Shareholders and Related Party Transactions

A description of the procedures for solicitation and voting of proxies and the conditions for their use, revocation, etc.

Other parts of the IOSCO Standards would be used if other matters were to be voted on. The solicitation also contain a description of the procedures for solicitation and voting of proxies and the conditions for their use, revocation, etc.

Solicitation of proxies for shareholders' votes in an extraordinary meeting would contain the parts of the IOSCO Standards that are applicable to the matter to be voted upon. It would also contain other material information and a description of the procedures for solicitation and voting of proxies and the conditions for their use, revocation, etc.

ENHANCING AND ENFORCING DISCLOSURE REQUIREMENTS

5. Publishing and Dissemination

Existing Requirements

The existing CML and ERs require that prospectuses, annual reports and semi-annual reports be filed with the CMA. A summary of prospectuses, annual reports and annual reports must be published in newspapers.

CMD Comments

Publication in newspapers is inordinately expensive for issuers. In addition, the summary information that is published is too abbreviated to be useful to investors.

CMD Recommendations

We recommend that the Egyptian public company disclosure system de-emphasize newspaper publication as the principal mode of information dissemination. It is too expensive under any cost-benefit analysis. Newspaper publication, if used at all, should be limited to a statement of the information that has recently become available and where to write, telephone, or e-mail to obtain it.

Issuers should be required to file all reports with the CMA and CASE and to mail the complete reports to all shareholders. The reports should also be mailed to any broker or member of the public that requests them.

We also recommend that the CMA or CASE put all filed disclosure documents on a web site. CMA and CASE should establish free public reference rooms where all filed disclosure documents could be read and copied at cost.

ENHANCING AND ENFORCING DISCLOSURE REQUIREMENTS

6. Enforcement

6.1 Prospectuses

Existing Requirements

The existing CML gives the CMA the power to review and require changes in prospectuses prior to their use.

CMD Comments

The powers of the CMA seem to be adequate to permit it to perform its duties under the CML.

CMD Recommendations

The CMA should be concerned only with disclosure. It should not attempt to set the price of securities. A review of the procedures of the CMA is beyond the scope of this report.

6.2 Periodic Reports

Existing Requirements

The existing CML requires periodic reports to be filed with the CMA. However, the law does not require periodic reports to contain non-financial information or to be provided to shareholders and market participants.

CMD Comments

The existing requirements do not conform to international best practice or the needs of the Egyptian market.

CMD Recommendations

We recommend that a way be found to require periodic reports to be sent to shareholders, market participants, and the CMA. The draft of the new CML will require this. We believe that it is not necessary to wait until the new law is adopted. CASE could amend its listing requirements to require periodic reports.

6.3 Solicitation of proxies for shareholder votes

Existing requirements

Proxies are not solicited.

CMD comments

International best practice includes solicitation of proxies as a means of protecting the shareholders' rights to vote at general meetings.

CMD recommendations

The draft of the new CML will require solicitation for election of directors. We believe that it is not necessary to wait until the new law is adopted. CASE could amend its listing requirements to require companies to solicit the proxies of shareholders in all matters upon which they may vote and to govern the procedures and disclosures required for that solicitation. CASE could impose penalties for companies that did not solicit proxies from shareholders.

ANNEX C

RULE ON DISCLOSURE

Article 1

No prospectus or periodic report filed with the Authority or a stock exchange shall include an untrue statement of a material fact or omit to state a material fact necessary to make the statements, in the light of the circumstances in which they were made, not misleading.

Article 2

No prospectus or periodic report filed with the Authority or a stock exchange shall omit a material fact.

Article 3

A material fact is any fact that a reasonable person would consider important in deciding to buy, hold or sell a security or in deciding how to vote.